

CSR, Sustainability, Ethics & Governance

Series Editors: Samuel O. Idowu · René Schmidpeter

Muhammad Azizul Islam

Social Compliance Accounting

Managing Legitimacy in Global Supply
Chains



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CSR, Sustainability, Ethics & Governance

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To my Son Master Waft Aousaf Islam

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Preface

While corporate social responsibility (CSR) has been highlighted in many reviewed journal articles, text, and research books, this book is unique in providing an interpretation of a specific CSR issue, social compliance within supply chains of multinational corporations (MNCs). Social compliance is now a major performance issue for MNCs that purchase products from suppliers in developing countries. This issue is relevant not only to corporate managers but also to practitioners, academics (researchers), and undergraduate and postgraduate business students.

The transfer of production to developing nations is growing fast. Accordingly, there is an urgent need to address the development of this new form of CSR, social compliance, which impacts on managers in both developed and developing nations. Social compliance is the means by which MNCs can meet expected social standards while achieving economic progress. It is generally a voluntary activity; however, in recent years it has become mandatory in a few countries around the world. For example, in the United States, The California Transparency in Supply Chains Act of 2010 has recently been enacted. This legislation requires retail sellers and manufacturers in California to disclose their efforts to eradicate slavery and human trafficking from the supply chains for tangible goods offered for sale.

The study covers some important discussions involving major US and European companies that source products from suppliers located in developing countries. The cases described in this book are internationally relevant and can be seen to reflect or represent the behaviour of many MNCs and their suppliers in developing nations. The primary motivation for the study is that, despite a growing amount of literature that focuses on CSR and supply chains, there is a general lack of research which investigates the particular CSR issue of social compliance. Discussion of this topic can offer in-depth knowledge about how levels of social compliance risk and pressure (including broader stakeholder concerns) influence managers to adopt or embrace particular social compliance accounting, reporting, and auditing strategies. The book provides an understanding of the major concerns, challenges, and dilemmas faced by management in the supply chains of MNCs and suggest what measures can be taken to solve those dilemmas. Most importantly, the book provides a systematic method of understanding the status of social compliance

performance of suppliers to MNCs. This includes significantly detailed accounts of the social compliance performance of suppliers within the clothing industry (in a developing nation) that supply goods to the extensive US and European markets.

The book offers a number of unique contributions to study in the CSR area. They are described below.

- This book offers comprehensive knowledge of social compliance for MNCs and their suppliers. Managers in supply chains often face dilemmas concerning social compliance issues such as child labour, forced labour, workers' health and safety, salary levels, and overtime. The book provides a rigorous amount of real examples of social compliance violations and offers some insights into practical guidelines, standards, techniques, and strategies which present and future managers can learn from. The book is significantly relevant to those who deal with various social compliance issues within supply chains.
- This book contributes to the debate about existing compliance standards and policy frameworks. There is widespread stakeholder criticism of the effectiveness of existing standards and related frameworks. The book also contributes to both regulatory and corporate policy formation. From a regulatory or corporate policymakers' perspective, the research findings provide knowledge of compliance measures to enhance policy considerations. From a corporate perspective, the research findings enhance the practical guidelines for corporations to curb violations of social compliance and ensure accountability and good governance within an organisation.
- The findings of this book are consistent with legitimacy theory, which posits that managers complete social compliance accounts, adopt social audits, and perform associated reporting in order to conform to the expectations of broader stakeholder groups. The apparent response by managers demonstrates a desire to maintain legitimacy while maintaining earnings.
- Social compliance accounting and auditing is a broad knowledge building activity. There is a striking imbalance between practical knowledge of social compliance and our understanding of the strategies to overcome the adverse effects of non-compliance. The findings of this book enhance knowledge of how we can prevent violations of social compliance within supply chains. The book contributes to accounting, management, and supply chains literature by broadening knowledge of how to account in such a way as to monitor and limit these violations.
- Hand in hand with globalisation and the associated impacts on the movement of global production sources to developing nations, the new profession of social compliance auditing is significantly growing. Almost every MNC and their suppliers in developing nations have social compliance auditors (either internal or external) to monitor how goods are produced and whether they are produced in compliance with codes of conduct and international standards. However, there is an urgent need to develop an understanding of how this emerging and influential discourse on social compliance is affecting corporate accountability systems and integrated reporting requirements. Thought leadership within the

audit and non-audit accounting professions is required regarding what the emerging social compliance discourse means for established practices and international reporting standards. The book therefore has clear implications for audit practice and policy development and aligns with the work of social compliance audit professions. Most importantly, the new audit professionals' growing interest in compliance systems has created a significant provocation to investigate corporate social compliance audit.

This is primarily a research book for scholars within the broader field of business administration. In other words, it is a valuable learning tool for researchers, postgraduate students (at the Master's and Doctorate levels) as well as undergraduate students in the areas of accounting, management, marketing, supply chain management, clothing fashion management, ethics, and social science. These are required areas of studies, and part of enrichment programmes, in universities and colleges where CSR is an element of both undergraduate and postgraduate programmes. The book also supports corporate managers (including supply chain managers and managers within MNCs) and thousands of compliance auditors within the supply chains, who are faced with challenging societal constraints when sourcing products from around the globe.

Brisbane

Muhammad Azizul Islam

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Chapter 1

Overview

1.1 Introduction

Social compliance refers to an organisation's adherence to certain social standards, including those related to child and forced labour, human trafficking, workers' health and safety, salary and overtime and freedom of speech and association. Social compliance standard setters as well as corporate managers are dedicated to ensuring there are no violations of social compliance through organisational actions. Social compliance has become an important issue for multinational companies (MNCs) that source products from suppliers in developing nations. This study documents the social compliance accounting, auditing and reporting practices of MNCs and their suppliers who operate in developing countries. While the key focus of this study is the garment manufacturing industry, some examples from other industries are considered, in order to understand the broader perspective on social compliance within supply chains. While social compliance is now a major performance issue for MNCs who buy products from suppliers in developing countries, the issue remains relevant to practitioners, academics, and business students at both undergraduate and postgraduate levels.

The study covers some important issues involving major retail MNCs sourcing products from the member suppliers of a major industry body in a developing country, the Bangladesh Garment Manufacturers and Exporters Association (BGMEA). The cases discussed in this book are internationally relevant and can be seen to reflect the behaviour of all MNCs and their suppliers who operate in developing nations. The primary motivation for the study is that, despite a growing amount of literature that focuses on corporate social responsibility and supply chains, there is a general lack of research that investigates this particular corporate social responsibility (CSR) issue (social compliance). Study in this area can offer in-depth knowledge about how levels of social compliance risk and pressure (including broader stakeholder concerns) motivate managers to adopt or embrace particular social compliance accounting, reporting and auditing strategies. The

study will provide significant understanding about the major concerns, challenges and dilemmas in the supply chains of MNCs and what measures need to be taken to ease those concerns. Most importantly, the study will provide a systematic method of understanding the status of the social compliance performance of suppliers to MNCs. This includes significantly detailed accounts of the social compliance performance of suppliers within the clothing industry (in a developing nation) that supply goods to the US and European markets.

Along with a review of the literature, archival documents and websites, this study incorporates interviews with a number of people (stakeholders as well as managers) as a means to understanding organisational performance in social compliance and accountability within global supply chains.

1.2 The Research Setting: Supply Chains of Multinational Corporations

Globalisation has led MNCs to shift their production locations to many different areas within developing nations. Developing nations have gradually become the most important source of products for MNCs for many reasons; one of those is because they can offer cheap labour. Suppliers in developing nations have been the subject of extensive international scrutiny, particularly in terms of violations of social compliance, such as the use of child and forced labour, poor or risky working conditions and associated mistreatment of employees. Social compliance issues frequently raised relate to employment of child labour, human rights abuse, poor working environments, and inadequate factory health and safety measures resulting in frequent accidents and deaths. MNCs are subjected to pressure on an international scale to take corrective measures so that violations of social compliance do not occur. This in turn impacts the operations of suppliers. Suppliers often face pressure from stakeholders to adopt and implement the codes of conduct of MNCs and other internationally acceptable standards. Despite the widespread implications of social compliance issues, and stakeholder concerns over these issues within supply chains, there exists a lack of research that specifically explores management's and stakeholders' actions, initiatives and strategies to curb violations of social compliance. This book particularly highlights social compliance accounting, auditing and reporting practices as preventative or corrective measures by managers within supply chains to curb violations of social compliance and maintain legitimacy. Through the author's own initiative, access to relevant data on compliance was provided by the BGMEA; global compliance standard setting bodies such as the International Labor Organisation (ILO); global non-governmental organisations (NGOs) such as Oxfam; internationally funded local NGOs; MNCs such as H&M and garment industry leaders. This type of access—which is typically unavailable in such research areas—was crucial to the results of the study. In addition to this, this book also relies on secondary data.

1.3 Chapter Outlines

The balance of this book is organised as follows:

Chapter 2 seeks to describe and summarise social accounting research in general. Key terms arising from the discussion are defined. The emergence of social accounting and of the major areas within social accounting research has been briefly introduced. In doing so the area of social compliance has been identified as a new topic of research. Social compliance accounting, reporting and auditing is seen as a subset of the social accounting discussed in this chapter. While this chapter identifies social compliance under the umbrella of social accounting, details of social compliance will be provided throughout the chapters of this book, to help the reader to understand the managerial strategies used in social compliance within the supply chains of MNCs.

Chapter 3 deals with three interrelated concepts of social compliance accountability: social compliance accounting, auditing and reporting. Social compliance accounting refers to measuring, understanding and reporting an organisation's social and ethical compliance. In other words, social compliance accounting is one type of social accounting dealing with measurement, recording and communication of conformance to the rules of social accountability or certain social standards by the organisation. This not only includes the organisation's own policies and practices but also those within its supply and distribution chains. It is a continuing process in which the involved parties keep on looking for better ways to protect the health, safety, and fundamental rights of their employees, and to protect and enhance the community and environment in which they operate.

A social compliance audit assesses health and safety, working conditions, or any other social issues existing in a facility or supply chain of a company. Three primary processes are involved in determining the performance of an organisation that is audited: they include document review, site inspections and interviews with workers, management and third-party stakeholders. Initial audits are undertaken to uncover breaches of acceptable standards. When follow up audits are undertaken, they are usually scaled back unless particular breaches have previously been identified or if information has been provided that social performance problems are potentially present. The rationales or objectives for performing a social compliance audit can be varied. Gray (2000) argues that there can be two mutually exclusive objectives of a social compliance audit. They can be undertaken for management control purposes and for assessing risk, managing stakeholders, image management, public relations, seeking out opportunities and efficiencies, publicising that the organisation is living by its values, and/or for maintaining legitimacy. By contrast, social compliance audits might be undertaken for accountability, democratic, and sustainability purposes with the aim of benefiting society through the pursuit of an organisation's objectives. Using this perspective, consideration would be given to stakeholders rights to information, balancing power with responsibility, empowering stakeholders, or owning up to eco-justice and ecological footprint failures.